No. 80-1049

CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1980

WESTERN CATHOLIC CHURCH, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

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The question presented in this federal income tax case is whether the Commissioner properly revoked petitioner's tax exempt status under Section 501(c)(3) of the Internal Revenue Code of 1954 (26 U.S.C.) on the grounds that it was not operated exclusively for exempt purposes and that part of its net income inured to the benefit of private individuals.

The pertinent facts may be summarized as follows: Petitioner[1] was incorporated in 1971 by S. Dean Slough and his wife and daughter. In its application for exemption from federal income tax, petitioner stated that its purpose was "to further religion and benefit mankind," and its proposed

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[1]Petitioner uses "Catholic" in its name in the lower-case sense of universal. Petitioner has no affiliation with the Roman Catholic Church or any similar organization (Pet. App. 4a-5a).

activities included the building of churches, colleges, nursing homes and a hospital. The application provided further that no single individual, group or organization would donate an amount exceeding ten percent of its assets, and that none of the officers or directors would be related by blood or marriage (Pet. App. 6a-7a, 10a). Based upon these representations, the Commissioner determined that petitioner met the requirements for exemption from federal income tax set under Section 501(c)(3). Contrary to the representations made in petitioner's exemption application, however, petitioner's only officers and directors during the taxable years at issue (1972-1974) were Slough and his wife and daughter. In addition, Slough himself donated and claimed a corresponding tax deduction for virtually all of petitioner's operating funds (Pet. App. 5a, 7a, 9a-10a, 24a).

Petitioner conducted no religious services or functions on a group basis during this period. Slough was petitioner's only minister, despite his lack of theological training (Pet. App. 7a), and he claimed that he spent about 10-12 hours per month talking with friends on a one-to-one basis in an attempt to get them to join the church.[2] Membership in the church required nothing more than an acceptance of petitioner's principles and an agreement to attend services when held in the future. Although Slough claimed that petitioner had 40 members, only Slough, his wife and daughter, and two individuals (one a longtime friend and the other a former employee) were identified as members (Pet. App. 8a).[3]

Petitioner's primary activity during these years was engaging in stock and real estate investments for the stated

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[2]Slough devoted his full-time attention to various business enterprises (Pet. App. 7a).

[3]The Tax Court determined that petitioner had only five members (Pet. App. 22a). Contrary to petitioner's assertion (Pet. 6), the government has never conceded that there were additional members.

purpose of accumulating money to build a church (Pet. App. 11a, 23a).[4] Petitioner obtained loans to finance many of these investments, often aided by Slough or his wholly-owned corporations. In addition, Slough occasionally borrowed money from petitioner for his own personal use (Pet. App. 15a).

During 1972, Slough wrote checks to cash from petitioner's bank account totalling $5,200. He testified that this money was donated to individuals personally known by him to be in need of financial assistance. Slough was able to identify only six recipients, however, who recieved a total of $3,875 (Pet. App. 8a-9a; R. 18; Tr. 54-55).[5] Petitioner also paid $1,600 to Slough's daughter (Pet. App. 27a).

On these facts, the Tax Court upheld the Commissioner's revocation of petitioner's tax-exempt status (Pet. App. 2a-28a). In the court's view, petitioner had not demonstrated that it was operated exclusively for religious purposes and that no part of its net earnings inured to the benefit of private individuals. As the Tax Court stated (Pet. App. 27a): "Petitioner was utilized by Slough as an 'incorporated pocketbook' into which he could transfer excess personal funds, claiming tax deductions, while he still retained complete control of the funds and used them for purposes unrelated to religious activities." The court of appeals affirmed on the Tax Court's opinion (Pet. App. 1a).

1. The decision below correctly upheld the Commissioner's revocation of petitioner's tax-exempt status. To qualify for income tax exemption under Section 501(c)(3), a corporation organized for religious purposes must show, among other things, that it was "operated exclusively for religious

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[4]Plans to build this church, however, did not proceed beyond the preliminary drawing stage (Pet. App. 10a).

[5]"R." refers to the separately bound record appendix filed in the court of appeals. "Tr." refers to the trial transcript.

* * * purposes." See *Stevens Bros. Foundation, Inc.* v. *Commissioner*, 324 F. 2d 633 (8th Cir. 1963), cert. denied, 376 U.S. 969 (1964). The term "exclusively" has been interpreted by this Court in a similar context to mean that a single non-exempt purpose, if substantial in nature, will defeat the claim to exemption. *Better Business Bureau* v. *United States*, 326 U.S. 279, 283 (1945).

Here, as the Tax Court correctly observed, "Petitioner's primary, if not sole, activity was the making of passive investments" (Pet. App. 23a). Only five persons were identified as members of the church, and no religious services or functions whatsoever were performed on a group basis. See *Bronner* v. *Commissioner*, 72 T.C. 368 (1979). Indeed, petitioner's only claimed religious activities during these years consisted of "one-to-one" conversations between Slough and his friends and the making of cash gifts to some of them. Such grants made only to Slough's personal friends rather than in an objective and non-discriminatory manner do not constitute an activity in furtherance of an exempt purpose. See *Church in Boston* v. *Commissioner*, 71 T.C. 102, 107 (1978).

2. Section 501(c)(3) of the 1954 Code further provides that an organization is not entitled to a tax exemption if any part of its net earnings "inures to the benefit of any private shareholder or individual." Here, the record discloses an intimate and frequently blurred financial interrelationship between petitioner on the one hand, and Slough and his wholly-owned corporations on the other. The money given to the church never passed out of Slough's control and was used entirely for investment purposes. Slough also occasionally borrowed money from petitioner for his own purposes. Although interest was paid, the loan itself evidences a private benefit to him. *Founding Church of Scientology* v. *United States*, 412 F. 2d 1197, 1202 (Ct. Cl. 1969), cert. denied, 397 U.S. 1009 (1970); *Unitary Mission Church of*

Long Island v. *Commissioner*, 74 T.C. 507, 515 (1980). Additional benefits to Slough and his family are evidenced by petitioner's inadequately explained $1,600 check to Slough's daughter (Pet. App. 27a; compare Tr. 28 with Tr. 106-107), the $5,200 in cash distributions made to his hand-picked recipients, and the purchase of an office building for the use of one of Slough's corporations. Indeed, the Tax Court specifically found that petitioner purchased the building at least in part because of that coporation's need for more office space (Pet. App. 26a). That purpose was plainly not a public benefit.

3. Contrary to petitioner's claims (Pet. 9-22), the decision below does not conflict with *Trinidad* v. *Sagrada Orden*, 263 U.S. 578 (1924). In that case and its progeny (see Pet. 13), it was clear that the organizations in question were operated exclusively for charitable purposes. Consequently, the conduct of an unrelated business "purely incidental to the pursuit of * * * [religious] purposes" (*Trinidad* v. *Sagrada Orden, supra,* 263 U.S. at 581), or the receipt of income from investments unrelated to the organizations' exempt purpose, did not cause the loss of tax exemption. But where, as here, the operation of the business or other unqualifying activity is itself that principal activity of the organization, no exemption from tax is permitted. See *Universal Oil Products Co.* v. *Campbell*, 181 F. 2d 451, 458 (7th Cir. 1950).[6] Thus, the courts below properly relied on *Randall Foundation* v. *Riddell*, 244 F. 2d 803 (9th Cir. 1957), where an organization's extensive stock trading activities

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[6]See also *Parker* v. *Commissioner*, 365 F. 2d 792 (8th Cir. 1966), cert. denied, 385 U.S. 1026 (1967); *People's Educational Camp Society, Inc.* v. *Commissioner*, 331 F. 2d 923 (2d Cir.), cert. denied, 379 U.S. 839 (1964); *Scripture Press Foundation* v. *United States*, 285 F. 2d 800 (Ct. Cl. 1961), cert. denied, 368 U.S. 985 (1962); *Leon A. Beeghly Fund* v. *Commissioner*, 35 T.C. 490 (1960), aff'd on other grounds, 310 F. 2d 756 (6th Cir. 1962).

resulted in the loss of tax exemption even though all the income and assets of the organization were, as here, earmarked for charitable endeavors. As the court noted, "a corporation * * * does not become a charity simply by announcing that it intends to devote the profits to charity" (244 F. 2d at 808).

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

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